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THE GUIDE TO RESTRUCTURING

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Editors
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CHAPTER 9

The Interplay between Different Stakeholders in Mexican Restructurings: Equity versus Debt

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The Insolvency Law[2] does not explicitly provide for informal out-of-court restructurings prior to insolvency; however, out-of-court restructuring may be entered into with all or a portion of a debtor's creditors. The creditors that do not enter into the restructuring plan will not be bound by the restructuring terms, and the original terms and conditions agreed with the debtor will remain in force and effect. Out-of-court restructuring is not mandatory for dissenting stakeholders.

Since most restructurings in Mexico are debtor-in-possession proceedings, the role of the company is always very important. The approval of a reorganisation plan will always require the debtor's approval, and in the equitisation of claims, certain corporate acts would need to be agreed by existing shareholders.

There is still a tendency in the courts to favour debtor protection. Courts constantly issue reliefs to protect the debtor, which allows a company to operate more easily during proceedings.

Court-appointed officials, such as examiners, conciliators and receivers, also have a key role as facilitators between the debtor, the creditors and the judge. They oversee the process, and are entitled to make proposals and authorise most of the company's relevant transactions.

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2 Ley de Concursos Mercantiles (https://mexico.justia.com/federales/leyes/ley-de-concursos-mercantiles/ (in Spanish) (last accessed 8 June 2022)).

The conciliator is important as a mediator between the creditors and debtor and has the capacity to make proposals and even authorise certain transactions.

Creditors are relevant, too, as the consent of a majority to the reorganisation plan is needed prior to its approval pursuant to the rules under the Insolvency Law. A validly approved agreement binds all unsecured creditors. Secured creditors that do not approve the agreement are not bound by it and may continue with the enforcement proceedings of their collateral, unless the plan provides for their full payment within the following 30 business days. If a company and its creditors reach a restructuring agreement during the conciliation stage, the company will pay its debts pursuant to the reorganisation plan and the insolvency proceeding (*concurso*) will be terminated.

Employees are given priority under the rules of insolvency proceedings. They are entitled to a salary and benefits as well as severance payments. These claims, and the enforcement of other labour and employment claims, are not subject to a *concurso* stay. Employees may amicably assist in the process or frustrate any attempted restructuring. Labour laws in Mexico are very protective and conservative, and employees cannot waive any accrued and unpaid benefits (including salary), making it very difficult to amend any labour conditions, such as economic conditions, suspensions or termination of relationships, without the consent of a labour court.

The interplay between the different stakeholders in the implementation of a financial and legal agreement is dependent on various factors: the situation of the debtor, the calibre and experience of the parties involved, and the jurisdictions involved, among other things.

The process can be complex, owing to the number of possible variants and, thus, the diversity of alternatives that can be applied during a restructuring process, depending on the expectations of the parties and the sector involved. The interests of all stakeholders in a restructuring proceeding – which can include the shareholders, board, employees (including unions), authorities, regulators and creditors (government, suppliers, banks, etc.) – must be taken into account.

The ability to reach consensual decisions among creditors is critical in a successful negotiation since restructurings in Mexico, as mentioned above, are mostly debtor-in-possession proceedings.

One of the main issues to be addressed in a Mexican restructuring is to restore trust among stakeholders to achieve an agreement. Whether this is achieved will depend to a large extent on communication and the delivery of credible and regular information to creditors.

The control of many listed companies in Mexico is in the hands of a family. This can result in the administration of the company being manipulated, which can bring about failures in internal controls. In many family-owned businesses, family members are on the board or in high-level official positions.

In certain cases concerning public service providers, the industry regulator has a key role in appointing the conciliator or receiver and also has the power of veto over the reorganisation plan.

Creditors with higher priority will be paid in full, and those with lower priority will be recompensed only if there are sufficient remaining funds. The current Insolvency Law classifies creditors in the following main categories or classes (and with the following rankings or preferences):

- first-priority claims against the 'estate' (assets) of the debtor (*créditos contra la masa*), which include:
    - special labour claims (severance payments and unpaid accrued wages) under Section XXIII, Chapter A of Article 123 of the Constitution and applicable regulations, by increasing wages during the corresponding two years prior to the *concurso* judgment (formal commencement of the *concurso* procedure of the debtor);
    - debt incurred for management of the estate of the debtor with the authorisation of the conciliator or the receiver, as the case may be, or those contracted directly by the conciliator;
    - debt (including debtor-in-possession financing) incurred to cover ordinary expenses for the safety and protection of the assets, and their repairs, conservation and management; and
    - debt incurred through judicial or extrajudicial acts for the benefit of the estate; provided, however, that under Article 225 of the Insolvency Law with respect to secured creditors, with mortgages or pledges, or creditors with special privileges,[3] the preference or privilege of the claims against the estate would not apply, except for the following claims:
        - the 'special labour claims' referred to above;
        - the litigation expenses incurred for the defence or recovery of goods or assets subject to the security interest of the secured claims or over those assets that are included as part of a 'special privilege'; and

3 Special privilege creditors are those that are qualified as such by law or that have a withholding right. A withholding right provides the possibility to withhold something that you do not own and that should be delivered to a third party. The person with a withholding right has the possession of an asset of a debtor and is authorised to have possession until the debtor fulfils his or her obligation.

  - the expenses necessary for the repair, conservation and sale of those assets;
- secured creditors (those with mortgages and pledges over assets of the debtor) and tax claims secured with a security *in rem* (up to the value of the guarantee), which are paid first with proceeds from the sale of mortgaged or pledged items. If the items have a value or a price in excess of the debt, any such excess or remaining value is directed to cover subsequent debt payments to other creditors. If the price does not cover the debt, mortgage or pledge, the corresponding creditor may participate, pro rata, as a common or unsecured creditor, to collect the remaining amount. In principle, assets transferred out of the estate in the form of true-sale vehicles (trust agreements) should be excluded from the estate (although such vehicles might be challenged if they have been structured as simple guarantee trusts rather than as true-sale mechanisms);
- other tax claims and general labour claims;
- common or unsecured creditors (trade creditors would usually rank as unsecured creditors and there are no particular mechanisms to secure their unpaid debts by statute); and
- subordinated creditors (intercompany claims).

Once a judge declares the debtor's bankruptcy or liquidation, shareholders would be liquidated only if there is any balance remaining after all creditors have been paid (either through a liquidation of the assets through public bids or by agreeing a reorganisation plan at the liquidation stage).

It is important to note that *concurso* provisions allow the debtor to incur unsecured or secured indebtedness in the ordinary course of business. If such credit is approved by the court or conciliator, as the case may be, it provides a priority claim or a lien to a lender on the debtor's unencumbered assets or a second priority claim on encumbered assets.

Debtor-in-possession loans have a priority claim in the insolvency, except for certain labour, tax and secured claims.

Case study: the airline industry

Owing to its complex nature, the airline industry[4] is one business that serves as a good example of debtors dealing with a number of counterparties and stakeholders. It is a unique environment with various actors involved and with challenges that require treatment from different perspectives.

4 For further discussion about the airline industry, see Chapter 14.

It is one of the most heavily regulated industries and any insolvency proceeding must rapidly assimilate and process a large amount of information and understanding of the business because of the sensitive timelines involved.

The airline industry is relevant to any government as it is a major contributor to the gross domestic product.

Likewise, asset preservation is key as aircraft depreciate rapidly if not operated and maintained regularly. Pilots are in high demand in the market and thousands of other jobs are supported by this industry.

Moreover, the very nature of the business means that the assets of the company may be located in more than one jurisdiction, and so the proceeding will turn into a cross-border insolvency.

The complexity of the industry is such that some jurisdictions have even developed, or are in the process of developing, legal provisions focused specifically on dealing with insolvencies in the airline sector.

Airline insolvencies differ from those of companies in other business sectors in a number of respects. Most of the matters are urgent and important and, therefore, have to be negotiated in parallel to running an airline as a going concern. In a recent case involving a Mexican airline, the main issues that had to be addressed simultaneously with making arrangements among stakeholders included the following:

- creditors and claims:
    - negotiations, arrangements and agreements had to be made with lessors, financing entities (many of them with heavy collateral securing their contracts), suppliers of services and products (food, appliances, spare parts, etc.), among other things; and
    - securing essential contracts and terminating non-essential ones;
- regulatory matters: one of the most relevant aspects as the airline industry is heavily regulated and regulations to which airlines are subject impose various limitations on the way they operate. Agreements had to be reached with the government and authorities with respect to licences, slots and traffic rights, taxes, fuel and airport charges, and antitrust matters; and
- employees and unions: the practitioners in this field are very highly skilled and technical. It was urgent to take action and negotiate new labour conditions and compensation plans with pilots, flight assistants and ground crew unions and the termination of certain existing labour relationships.

APPENDIX 1

About the Authors

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Alejandro Sainz was the founding partner of Cervantes Sainz, which was spun off into Sainz Abogados. He chairs the restructurings and insolvency practice area and is a member of the finance, compliance and investigations, and mergers and acquisitions practice groups at Sainz Abogados.

He has more than 30 years of experience in advising and representing clients in the practices of cross-border insolvency and restructurings (out-of-court and in-court – *concursos mercantiles*), finance, refinancing and corporate reorganisations, as well as in the purchase and sale of assets in special situations and distress. He has represented clients from various industries, both nationally and internationally, domestic and foreign companies, public and private, as well as several ad hoc committees of international bondholders and noteholders issued abroad by Mexican issuers.

He is also recognised for his service to the community, giving pro bono advice to new entrepreneurs and companies, and non-profit organisations that need help in specific matters of law.

Alejandro is a certified mediator with the Mexican Institute of Mediation, and was a professor at the Iberoamerican University; he has taught and spoken on various courses, seminars, postgraduate courses and conferences, in Mexico and abroad, on matters of corporate restructurings and cross-border restructurings and insolvency proceedings. He is a member of various boards of directors and committees.

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Ana Gabriela Avendaño is an associate at Sainz Abogados. She has experience in insolvency procedures, bankruptcy, complex restructurings, and banking and finance matters. She has represented national and foreign clients, including creditors' committees, debtors and other relevant entities on insolvency proceedings, consensual restructurings and winding-up proceedings.

She obtained her law degree (JD) in 2004 from the Autonomous Technological Institute of Mexico (ITAM) in Mexico City, and obtained an LLM degree from The University of Virginia School of Law in 2007.

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This Guide delivers specialist insight to our readers across the region – advisers, practitioners, corporate decision makers and court officials – throughout the process.

In preparing this Guide, we are grateful for the cooperation and insight of the broad range of participating advisers and practitioners, who have contributed a wealth of knowledge and experience.

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